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No.

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ALEXANDER L. STEVAS,
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1983

KEMMONS WILSON,
Petitioner,

v.

W. HAMILTON CRAWFORD, LILLIAN W. CRAWFORD, MACK H. HORNBEAK, DOROTHY C. KIMBALL and COVINGTON FUNDING COMPANY,
Respondents.

CRAWFORD CORPORATION,
Petitioner,

v.

W. HAMILTON CRAWFORD and LILLIAN W. CRAWFORD,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

JOHN D. MARTIN, JR.
S. SHEPHERD TATE
LEE L. PIOVARCY
DAVID WADE
JIMMY L. VERNER, JR.
MARTIN, TATE,
MORROW & MARSTON, P.C.
705 Union Planters Bank Building
Memphis, Tennessee 38103
Attorneys for Petitioner

St. Louis Law Printing Co., Inc., 411 No. Tenth Street 63101 314-231-4477

QUESTIONS PRESENTED FOR REVIEW

1. Is it an abuse of discretion and contrary to the public policy of the United States to deny a jury trial solely on the ground that the application of the Jury Selection and Service Act of 1968 to the selection of jurors produces incompetent jurors?

2. What is the proper standard for the exercise of a trial court's discretion in deciding whether to grant trial by jury when the time for requesting a jury under the Federal Rules of Civil Procedure has passed?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

OPINIONS BELOW

1. *Crawford* v. *Wilson,* No. 81-5066; *Crawford Corporation* v. *Crawford,* No. 81-5066; *Wilson* v. *Covington Funding Co.,* No. 81-5067, (6th Cir. Nov. 24, 1982).

2. *Crawford* v. *Wilson,* No. 81-5066; *Crawford Corporation* v. *Crawford,* No. 81- 5066; *Wilson* v. *Covington Funding Co.,* No. 81-5067, (6th Cir. Jan. 4, 1983) (order denying petition for rehearing).

GROUNDS FOR JURISDICTION

The judgment sought to be reviewed was dated and entered on November 24, 1982.

An order denying Petition for Rehearing was entered on January 4, 1983.

Jurisdiction is conferred on this Court to review by certiorari the judgment of the Court of Appeals by 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES, AND RULES OF COURT INVOLVED

U.S. Const. amend. VII:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

Fed. R. Civ. P. 38:

> Rule 38 *Jury Trial of Right.*
>
> (a) *Right Preserved.* The right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States shall be preserved to the parties inviolate.
>
> (b) *Demand.* Any party may demand a trial by jury of any issue triable of right by a jury by serving upon the other parties a demand therefor in writing at any time after the commencement of the action and not later than 10 days after the service of the last pleading directed to such issue. Such demand may be endorsed upon a pleading of the party.

* * * *

(d) *Waiver.* The failure of a party to serve a demand as required by this rule and to file it as required by Rule 5(d) constitutes a waiver by him of trial by jury. A demand for trial by jury made as herein provided may not be withdrawn without the consent of the parties.

Fed. R. Civ. P. 39(b):

Rule 39. *Trial by Jury or by the Court.*

* * * *

(b) *By the Court.* Issues not demanded for trial by jury as provided in Rule 38 shall be tried by the court; but, notwithstanding the failure of a party to demand a jury in an action in which such a demand might have been made of right, the court in its discretion upon motion may order a trial by a jury of any or all issues.

STATEMENT OF THE CASE

In 1973, Petitioner Kemmons Wilson entered into negotiations with Respondents W. Hamilton Crawford and his wife, Lillian W. Crawford, to acquire stock in Petitioner Crawford Corporation. These negotiations resulted in Wilson's purchase in 1974 of one-third of the Crawfords' stock in Crawford Corporation and the corporation itself purchasing the remaining two-thirds of the Crawfords' stock. As part of their consideration for the stock, the Crawfords received purchase money promissory notes from both Wilson and Crawford Corporation, a public company. Wilson utilized similar transactions to purchase the Crawford Corporation stock owned by Respondents Mack H. Hornbeak and Dorothy C. Kimball. Respondent Covington Funding Company, as the agent for the other respondents, structured the sale of the Crawford Corporation stock. Respondents W. Hamilton Crawford and Lillian W. Crawford paid Covington for its services with a promissory note

issued by Wilson. Respondents altogether sold 175,037 shares to Wilson and tendered 350,062 shares to the corporation. In addition to the promissory notes, they received in excess of $2,500,000 in cash. As a result of these transactions controlling interest in Crawford Corporation passed from the Crawfords to Wilson.

The Crawfords thereafter commenced a diversity action against Wilson in the United States District Court for the Western District of Tennessee to collect on these promissory notes. The remaining Respondents followed suit, Hornbeak and Kimball to recover on their purchase money notes and Covington on the note for its fee. Crawford Corporation commenced a declaratory judgment action against the Crawfords in the same court.

The parties had calculated the stock's purchase price on the book value of the stock. Wilson's defense to the lawsuit centered on the incorrect book value of the stock stated in Crawford Corporation's December 31, 1973, financial statements. Wilson alleged that Crawford Corporation's accountants had not prepared these financial statements in accordance with generally accepted accounting principles. In addition, Wilson alleged that Crawford had misrepresented to him that Crawford Corporation's real estate was extremely valuable because it could be developed, when in fact governmental restrictions and easements prevented development.

Crawford Corporation alleged that it did not owe the face amount of the notes it issued the Crawfords because the Crawfords had inflated the stock's book value in the December 31, 1973, financial statements. Crawford Corporation suffered a substantial loss when it redeemed its own shares from some, but not all, of the shareholders at an inflated price based on an overstated book value.

The district court consolidated these cases for trial.

In the early pleading stage of the cases, none of the parties demanded a jury trial. Petitioners perceived that the case primarily would be resolved by a factual analysis of technical accounting principles and that a trial by the court was the best method for making such an analysis.

However, as trial preparations progressed, Respondents moved away from these technical concepts.[1] Responents stated many times in pre-trial appearances before the court that the case was not complicated, involving simply a suit on the notes. Respondents insisted that Wilson was an astute businessman and was capable of making up his own mind about the value of the stock which he purchased and about the development potential and value of the corporation's real estate holdings. Further, Respondents began to elicit deposition testimony concerning Mr. Crawford's reputation for truth and veracity. As the discovery period of the case proceeded, it became clear to Wilson and Crawford Corporation that Respondents intended to attempt to sidestep the accounting problems they faced.

One year before trial, Respondents requested at a pre-trial conference that the court direct Wilson and Crawford Corporation to proceed as plaintiffs. The court so ruled with the concurrence of all the parties.

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[1] This shift in emphasis was probably "good trial tactics" since the accountants who had prepared the 1973 financial statements later conceded that the statements should be restated showing a much lower book value. Further, during discovery, Petitioners uncovered correspondence from the accountants to W. Hamilton Crawford in which the accountants had challenged the propriety of the very method upon which Mr. Crawford had insisted to report the higher book value. Mr. Crawford had withheld this correspondence when he transferred the corporate files to Wilson after the stock sale.

Respondents thereafter assumed the posture of defendants, pinning their defense on issues of credibility and intent. Wilson and Crawford Corporation, now standing as plaintiffs, found themselves approaching not a technical battle over accounting concepts but one dealing with credibility and intent. Because of the procedural shift in the case and the change in issues, Wilson and Crawford Corporation moved the trial court ten months prior to trial for a jury to hear all issues of fact in the consolidated cases, pursuant to Fed. R. Civ. P. 39(b).

Respondents relied on the minority rule of the United States Courts of Appeals for the Second, Fourth and Ninth Circuits and argued that the judge possessed severely limited discretion to grant a jury trial after the demand period had expired. They contended that except in the rarest of cases, a trial court should not grant a trial by jury in default of a timely request for it. In addition, contrary to all earlier statements about the simplicity of the issues, Respondents argued that the case involved complex accounting issues and a complicated contract.

At the hearing on the motion, the trial court stated:

> As you know, *we get our juries these days by random selection from voter registration lists,* and for most cases the court would say that these people are fine. They are the salt of the earth. But when you get into a business-type lawsuit, which is what this is, *we get so many jurors who frankly, they may be reasonably intelligent and certainly try to do the job, but they simply don't have the background to understand what we are dealing with,* and, therefore, it seems to me it is completely unrealistic for this court to exercise its discretion and to have a jury trial. . . .(emphasis added).

By order entered on January 23, 1979, the trial court denied the motion of Wilson and Crawford Corporation for a trial by jury of the consolidated cases.

The court, sitting in Memphis, subsequently tried the cases, and on July 28, 1980, issued its Memorandum Decision allowing Wilson certain minor set-offs but denying all of Petitioners' claims with respect to the misrepresentations made to them by Respondents. The court noted the reputation proof that Respondents had put into evidence. Looking to the conduct of the parties, the court analyzed the backgrounds of Wilson and W. Hamilton Crawford, discussed the negotiations between the two men, and made *findings of fact* with respect to intent, scienter and reliance.[2] The court specifically held that it would *not* decide the case on the technical issues concerning (1) whether Crawford Corporation's accountants reported certain transactions in the 1973 financial statements in accordance with generally accepted accounting principles, and (2) whether W. Hamilton Crawford had correctly stated the real estate development potential and property values. The court ignored expert testimony on both issues.

On November 24, 1982, the United States Court of Appeals for the Sixth Circuit substantially affirmed the judgment of the trial court. However, the Sixth Circuit remanded the case of Crawford Corporation because of the trial court's failure to make additional findings on the issue of breach of fiduciary duty. The Sixth Circuit tersely dispatched the overruled jury trial request, concluding that there was "no abuse of discretion in the denial."

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[2] For example, the trial court's sole and rather cryptic finding on the scienter issue was: "We think Wilson has not shown scienter, read to include recklessness, with respect to most, if not all, of Crawford's estimate of values." *Crawford* v. *Wilson*, No. C-77-2295, slip op. at 20 (W.D. Tenn. July 28, 1980).

ARGUMENT

REASONS FOR GRANTING THE WRIT

I.

It is an abuse of discretion and contrary to the public policy of the United States to deny a jury trial solely on the ground that the Jury Selection and Service Act of 1968 produces incompetent jurors. This is especially true when, as here, a case is decided on the intent, conduct and veracity of parties rather than upon technical accounting principles.

In denying a trial by jury to Wilson and Crawford Corporation, the trial court cited the lack of background of "juries these days." The Court specifically contrasted today's juries with those called upon for service in the past, noting that randomly selected jurors lack the capacity to comprehend a "business-type lawsuit."[1]

The trial court's statement is appallingly contradictory to public policy as promulgated by the Congress of the United States. Congress enacted the Jury Selection and Service Act of 1968 (the "Act") specifically to prohibit the exclusion of citizens from jury service on the basis of "race, color, religion, sex, national origin, or economic status." 28 U.S.C. § 1862. Its policy is to extend to all litigants the right to "juries selected at random from a fair cross section of the community." *Id.* § 1861. Moreover, the Act establishes that "all citizens shall have the opportunity to be considered for service . . . and shall have an obligation to serve as jurors when summoned." *Id.*

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[1]The trial court nearly paraphrases a famous but cynical author's assessment of the jury system: "The jury system puts a ban upon intelligence and honesty, and a premium upon ignorance, stupidity, and perjury. It is a shame that we must continue to use a worthless system because it was good a thousand years ago." M. Twain, *Roughing It,* in *The Complete Works of Mark Twain* 309 (1972).

This Act effectuates the type of jury selection system which the United States Supreme Court, by constitutional mandate, has required the several states to adopt. The random selection mandate developed in the 1960's, primarily in the racial context. *See, e.g., Coleman* v. *Alabama,* 377 U.S. 129 (1964); *Arnold* v. *North Carolina,* 376 U.S. 773 (1964). Random selection also means that the states no longer can exclude women from jury service by granting them automatic exemptions. *Taylor* v. *Louisiana,* 419 U.S. 522 (1975). The Act itself did away with economic discrimination by precluding jury selection systems which gravitated toward higher income groups. *Davis* v. *United States,* 411 U.S. 233, 235 n.2 (1973).

The Act has insured random selection of juries for the purpose of safeguarding the highest of constitutional standards: trial by a fair, unbiased, representative cross section of the community. The trial court, in the case *sub judice,* turned that purpose inside out by its ruling which denigrates juries that are the product of the random selection process.

Discretion does not include a right to act at cross purposes to national policy:

> When [judges] are said to exercise a discretion, it is a mere legal discretion, a discretion to be exercised in discerning the course prescribed by law; and, when that is discerned, it is the duty of the court to follow it. Judicial power is never exercised for the purpose of giving effect to the will of the judge; always for the purpose of giving effect to the will of the legislature; or, in other words, to the will of the law.

Osborn v. *Bank of the United States,* 22 U.S. (9 Wheat.) 738, 866 (1824).

In this case, the legislative will was undone when its constitutional purpose to guarantee random jury selection free of racial, sexual and economic bias became the only rationale for the

denial of a jury trial. The district court, having cited an improper reason violative of public policy for its action, erred in denying Petitioners trial by jury.

II.

There is a conflict among the circuits as to the proper standard for the exercise of a trial court's discretion in deciding whether to grant trial by jury once the time for requesting it has expired. One respected commentator has insisted that the wide divergence of view on how a court should exercise its discretion on a motion under Fed. R. Civ. P. 39(b) encompasses three separate rules among the courts of the United States. 9 C. Wright & A. Miller, *Federal Practice and Procedure* § 2334 (1971).

In the Fifth, Sixth, Eighth and Tenth Circuits, a trial court should grant a Rule 39(b) motion in the absence of strong and compelling reasons to the contrary. *Swofford* v. *B & W, Inc.*, 336 F.2d 406 (5th Cir. 1964), *cert. denied*, 379 U.S. 962 (1965); *Local 783, Allied Industrial Workers* v. *General Electric Co.*, 471 F.2d 751 (6th Cir.), *cert. denied*, 414 U.S. 822 (1973); *Littlefield* v. *Fort Dodge Messenger*, 614 F.2d 581 (8th Cir.), *cert. denied*, 445 U.S. 945 (1980); *AMF Tuboscope, Inc.* v. *Cunningham*, 352 F.2d 150 (10th Cir. 1965).

The Second, Fourth and Ninth Circuits hold to nearly the opposite view that a trial court has no discretion to grant a jury trial under Rule 39(b) unless the party making the motion can show that exceptional circumstances underlie the request for relief. *Galella* v. *Onassis*, 487 F.2d 986 (2d Cir. 1973); *Noonan* v. *Cunard Steamship Co.*, 375 F.2d 69 (2d Cir. 1967); *McCray* v. *Burrell*, 516 F.2d 357, 371 (4th Cir. 1975), *cert. dismissed*, 426 U.S. 471 (1976); *General Tire & Rubber Co.* v. *Watkins*, 331 F.2d 192 (4th Cir.), *cert. denied*, 377 U.S. 952 (1964); *Mardesich* v. *Marciel*, 538 F.2d 848 (9th Cir. 1976); *Rutledge* v. *Electric Hose & Rubber Co.*, 511 F.2d 668 (9th Cir. 1975).

Yet a third line of cases effectively abrogates altogether the trial court's discretionary power. One court, for instance, has followed an unbending practice never to grant such a motion, *Ligouri* v. *New York, N.H. & H.R.R. Co.*, 26 F.R.D. 565 (D. Conn. 1961), while other courts have refused to grant relief if an objection is filed to the motion. *A & W Oil Co.* v. *Texaco, Inc.*, 51 F.R.D. 283 (W.D. Ark. 1970); *Buescher* v. *Auto Lite Battery Corp.*, 11 F.R.D. 514 (N.D. Ohio 1951).[4]

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[4]The inconsistent application even within the circuits is demonstrated by a simple comparison between the instant case and *Davis-Watkins Co.* v. *Service Merchandise Co., Inc.*, 500 F. Supp. 1244 (M.D. Tenn. 1980), *aff'd*, 686 F.2d 1190 (6th Cir. 1982). In *Davis* a jury trial was granted more than three years after the commencement of discovery and more than fourteen months after the defendant had filed its counterclaim. The plaintiff had urged the court not to grant the jury trial motion on the ground that a complex antitrust case is not proper for jury consideration. The court considered that the trial was estimated to last six weeks; that the amount of evidence to be introduced was massive; that seventy-four persons were listed as witnesses, at least four of whom were experts; and that the jury instructions would be lengthy. Even so, the court, citing its reluctance to find sufficient complexity to remove the case from the jury, said:

> The civil jury trial was provided for in the Bill of Rights to the United States Constitution and has been a hallmark of the English and American system of justice for centuries. A discretionary request for a jury trial should not be denied unless compelling reasons support the denial. The rationale for denying a jury in this case is simply not compelling.

Id. at 1252.

By contrast, the consolidated cases, *sub judice*, did not begin to approach the size and complexity of the *Davis* case. The claims of the parties were tried in twelve days, and approximately twenty witnesses testified. As the trial court's Memorandum Decision reveals, the decision was made not on issues of technical complexity, but rather on traditional jury issues of intent, credibility, and reliance.

As it turns out, Petitioners would have had their jury had they lived east of the Tennessee River in the Middle District of Tennessee.

This uncertainty belies the avowed strength of the federal policy which has historically favored trial by jury. The Seventh Amendment to the Constitution of the United States has clearly preserved the right to trial by jury as it existed at common law. 5 J. Moore, J. Lucas & J. Wicker, *Moore's Federal Practice* ¶ 38.08[5] (2d ed. 1982). Moreover, the federal system has jealously guarded the "essential characteristic" of common law actions, which "under the influence - if not the command - of the Seventh Amendment, assigns the decisions of disputed questions of fact to the jury." *Byrd* v. *Blue Ridge Cooperative*, 356 U.S. 525, 537 (1958). The federal policy favoring jury trials is of "historic and continuing strength." *Simler* v. *Conner*, 372 U.S. 221, 222 (1963); *Byrd* v. *Blue Ridge Cooperative*, 356 U.S. at 538.

The lack of a consistent rule among the circuits for the proper exercise of discretion in an area so closely guarded by the Constitution is problematic. It is intolerable that the rule in one circuit often is diametrically opposed to that in another circuit. The enunciation by this Court of a standard for the exercise of discretion would insure a uniformity which would remove mere geographic location as the controlling factor over whether citizens can enjoy a trial by jury, if they request it under Rule 39(b).

This divergence of judicial attitude towards juries is not uncommon. For example, the Senior United States District Judge for the District of Minnesota has questioned the competence and utility of the American jury system, arguing that the system is an anachronism. *See* Devitt, *Should Jury Trial Be Required in Civil Cases? A Challenge to the Seventh Amendment*, 47 J. Air L. & Com. 493 (1982). The contrary judicial view that trial by jury has a hallowed place and a practical function in our system caused a District Judge for the United States District Court for the Northern District of Texas to assert that there is no reason to presume that judges are more adept than juries at comprehending complex cases. *See* Higginbotham, *Continuing the Dialogue: Civil Juries and the Allocation of Judicial Power*, 56 Tex. L. Rev. 47 (1977).

Of course, the very concept of discretion implies the absence of a hard and fast rule. But that does not mean that the exercise of discretion ought to be limitless and without uniform guidelines. In fact, "judicial discretion" can be exercised only in a manner consistent with and not opposed to the course prescribed by the law. *Osborn* v. *Bank of the United States*, 22 U.S. (9 Wheat.) 738, 866 (1824). In exercising its discretion, a court cannot disregard the substantive principles of law established for the protection of litigants. *Cohen* v. *Young*, 127 F.2d 721 (6th Cir. 1942).

Petitioners assert that these controlling principles certainly cannot allow the trial court's "discretionary" undermining of the Jury Selection and Service Act of 1968 by denying the jury trial request because the randomly selected jurors would be incompetent. But even if the trial court had denied the request for a proper reason, uniform standards are needed among the circuits for the exercise of discretion under Fed. R. Civ. P. 39(b) to resolve the disparity of treatment among the federal courts.[5]

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[5] An analogous situation in which this Court granted certiorari to adopt a standard for the exercise of discretion concerns the granting of a motion to amend pleadings pursuant to Fed. R. Civ. P. 15(a). The grant of leave to amend is discretionary with the trial court, *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 401 U.S. 321 (1971), but the exercise of discretion is not without limits. This Court specifically set out these limits in *Foman* v. *Davis*, 371 U.S. 178 (1962):

> In the absence of any apparent or declared reason — such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. — the leave sought should, as the rules require, be "freely given."

Id. at 182.

Because this Court set the boundaries within which judicial discretion should operate in allowing amended pleadings, this once disturbing area has been all but quieted as a contested issue in the federal system.

IV.

CONCLUSION

There is a great danger in unguided judicial discretion when it encounters areas of constitutional sensitivity. Lack of consistency can subject a constitutional priority to the vagaries of the geographic location of the forum. Requests for trial by jury well in advance of trial, albeit after the time for requesting it has passed, is an area in which a trial court's predispositions about the competency of jurors can have more of an effect on a ruling than can the merits of the requests for relief. The rule of law, not the individual will of the jurist, should guide discretion. Whether this Court should adopt the view espoused by the Fifth, Sixth, Eighth and Tenth Circuits or that of the Second, Fourth and Ninth Circuits is not the important issue in the end. Establishing a nationwide standard for the application of Rule 39(b) would provide parties more certainty in litigation and remove a potential ground for appeal to this Court.

Respectfully submitted,

JOHN D. MARTIN, JR.
S. SHEPHERD TATE
LEE L. PIOVARCY
DAVID WADE
JIMMY L. VERNER, JR.
Martin, Tate, Morrow
Marston, P.C.
705 Union Planters Bank Building
Memphis, Tennessee 38103

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APPENDIX A

Transcript Of Court Ruling At Hearing Of January 19, 1979 On Motion For Jury Trial

[22] THE COURT: Let me say this, gentlemen: As you know, we get our juries these days by random selection from voter registration lists, and for most cases the court would say that these people are fine. They are the salt of the earth. But when you get into s business-type lawsuit, which is what this is, we get so many jurors who frankly, they may be reasonably intelligent and certainly try to do [23] the job, but they simply don't have the background to understand what we are dealing with, and, therefore, it seems to me it is completely unrealistic for this court to exercise its discretion and to have a jury trial in a complicated type of business lawsuit like this. I might say we get other cases in which we have complicated situations and simply can't avoid a jury — income tax fraud cases, and we have juries that have a gut feeling about it, but they don't really — a lot of them don't — don't understand what is going on. I am not depreciating their intelligence. I am not depreciating their honesty. But they just don't have the background. They don't have the familiarity with business and business terms, and that type thing. So it seems to me it would be totally unrealistic to switch now and call this jury case. We have had some recent experience in this area, and I think to submit a complicated business case to a lot of jurors that we have these days, as hard as they try, and as intelligent as they may be, because of their lack of background in these matters, that it brings a fortuitous result.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

Civil C-77-2295

W. Hamilton Crawford and Lillian W. Crawford,
Plaintiffs,

v.

Kemmons Wilson,
Defendant.

Civil C-77-2325

Mack Hornbeak,
Plaintiff,

v.

Kemmons Wilson,
Defendant.

Civil C-77-2326

Dorothy C. Kimball,
Plaintiff,

v.

Kemmons Wilson,
Defendant.

Civil C-77-2327

Crawford Corporation,
Plaintiff,

v.

W. Hamilton Crawford and Lillian W. Crawford,
Defendants.

Civil C-77-2378

Kemmons Wilson,
Plaintiff,

v.

Covington Funding Company,
Defendant.

ORDER DENYING MOTION FOR JURY TRIAL

This cause is before the court on the motion of Kemmons Wilson, both as a defendant and a plaintiff, and the motion of Crawford Corporation for trial by jury in these cases. It is conceded by movants that a jury trial was not timely demanded, and they are seeking to have this court exercise its informed discretion in granting a jury trial at this time. Opposing parties object to the granting of a jury trial.

This court agrees that, even where a jury trial is not timely demanded, it should be granted unless there is an affirmative and good reason not to so grant a jury trial. In these cases, it is the opinion of the court that a jury trial should not be granted because the cases involve business transactions of considerable complication which would be outside the knowledge or experience of the average juror. Indeed, based upon our

knowledge of the issues that will be involved, it might well be a matter of extreme difficulty to submit these cases to a jury.

It is therefore ORDERED that the motions for a jury trial be and the same are hereby denied.

ENTER this 23rd day of January, 1978.

/s/ Bailey Brown
CHIEF JUDGE

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

No. C-77-2295

W. Hamilton Crawford and Lillian W. Crawford,
Plaintiffs,

v.

Kemmons Wilson,
Defendant.

No. C-77-2325

Mack Hornbeak,
Plaintiff,

v.

Kemmons Wilson,
Defendant.

No. C-77-2326

Dorothy C. Kimball,
Plaintiff,

v.

Kemmons Wilson,
Defendant.

No. C-77-2327

Crawford Corporation,
Plaintiff,

v.

W. Hamilton Crawford and Lillian W. Crawford,
Defendants.

No. C-77-2378

Kemmons Wilson,
Plaintiff,

v.

Covington Funding Company,
Defendant.

MEMORANDUM DECISION

These actions were brought in 1977, following which there was extensive discovery and, as will be reflected in this opinion, there were hearings on motions for partial summary judgment. Jurisdiction is based on diversity of citizenship (28 U.S.C. § 1332) and, since federal securities law violations are alleged, on 15 U.S.C. § 77v and § 78aa. A bench trial was held and this memorandum will constitute the court's findings and conclusions. A request was made for post-hearing argument after the briefs were in. Since the parties suing on their notes filed post-trial briefs and proposed findings consisting of 60 pages and the parties seeking set-offs with respect to such notes have filed post-trial briefs and proposed findings consisting of 210 pages, we believe that we are sufficiently apprised of the factual and legal contentions of the parties.

These actions involve, in 1973 and 1974, negotiations for and ultimately the sale of part of the stock of Crawford Corporation and, almost concurrently, the purchase by the corporation of a large part of its remaining stock pursuant to a tender offer. The key figures in these transactions that gave rise to this litigation are W. Hamilton Crawford of Baton Rouge and Kemmons Wilson of Memphis.

Both Crawford and Wilson were and are wealthy men. Crawford is in his seventies and has been involved in real estate and the purchase and development of land for many years. Though irascible, which he amply demonstrated on the witness stand, and though he has a reputation for being a hard bargainer, Crawford also has a good reputation as being honest in his dealings. Wilson, who also is a hard bargainer but has a good reputation for fair dealing, is in his sixties and was the founder and for many years chairman of the board of Holiday Inns of America. He has also been otherwise involved in real estate, such as ownership of a brokerage company and the purchase and development of property including shopping centers. One could fairly say that it would be hard to find two persons more knowledgeable about real estate and real estate development than are Crawford and Wilson. They are experts and have prospered in the business.

The Crawford Corporation was owner of some land and all of the stock of the Crofton Corporation and Crawford Homes, Inc. Crofton Corporation was the vehicle through which the "model community" of Crofton, Maryland was created; the town is located about midway between Washington and Baltimore. By 1973, most of the large tract that Crofton Corporation had purchased for the development had been sold but it still owned a substantial amount of the property there. Crawford Homes owned some land.

Crawford Corporation had outstanding 710,094 shares of stock, and though Crawford and his wife, Lillian, together held 493,350 shares, it was a public corporation in that, in addition to 31,900 shares held by the three directors other than Crawford, there were over 300 other stockholders and the stock was traded in the over-the-counter market. Crawford had decided by 1973 that he would like to liquidate his interest in the corporation and wind down his business activities.

Wilson, on the other hand, was interested in acquiring control of a public corporation, with an initial investment of as little cash as possible, which he could in turn place in various businesses and thus develop a mini-conglomerate.

Wilson and Crawford were brought together by A. Sam Gittlin, president of Covington Funding Company of New York, a financial consulting and services company. Robert Armstrong, who had been a bank officer in Memphis and who had been employed by Wilson to aid him in his search for such a corporation and who later became president of Crawford Corporation after Wilson gained control, was first in contact with Gittlin in June, 1973, and Crawford then visited Wilson in Memphis in early August, 1973, and discussed a sale of Crawford Corporation stock at a reasonable amount over book value.

In early September, 1973, Crawford, Wilson, and Gittlin met at Crofton to give Wilson an opportunity to look over the property there and to discuss further Wilson's acquiring control of Crawford Corporation. Crawford made some estimates of cash to be received by the corporation from ongoing deals which were not pessimistic but also admitted that the cost basis of his stock was only $2.70 per share. Wilson said he was interested in purchasing the Crawfords' stock if Gittlin could figure out a way for him to do so by getting all or most of the necessary funds to make the purchase from cash in the corporation. Gittlin suggested the possibility of Wilson's purchasing part of the

shares and having the corporation redeem about two-thirds of the remaining shares with cash that it would have. Gittlin also resolved after the meeting that he would suggest to Crawford that the sale should be on the basis of book value, to be established by upcoming financial statements, which would be attractive to Wilson since book value appeared to be increasing as property was sold off.

On September 12, 1973, Crawford wrote to Wilson (Ex. 2) setting out book values and estimated market values of the properties of the Crawford Corporation and its subsidiaries as well as the estimated book value of the shares as of December 31, 1973 at $15.17 per share. He indicated that he wanted a slight amount over book, specifically $16.00 per share. He estimated that Wilson could make a profit of $4,300,000 to $7,500,000 upon further liquidation of the properties. The representations contained in this letter are the principal bases for the claims of fraud made by Wilson discussed herein.

Wilson replied on September 19 that he had no interest in purchasing at a price in excess of $12.00 per share. He stated that the Crawfords would come out better by accepting from him $12.00 per share for their stock than they would if the corporation completed its liquidation of its properties with the Crawfords still owning their stock.

On October 25, 1973, Wilson, Crawford, Gittlin, and Crawford's attorney, John D. Martin, Jr., had a meeting in Memphis wherein they signed a one-page agreement (Ex. 3 and Ex. 158) whereby Wilson would purchase all of the Crawfords' stock at $14.00 per share, $9.00 in cash and $5.00 in notes to be secured by Holiday Inns stock. It was further agreed that the deal would not be closed until Crawford Corporation had at least $7,500,000 cash or equivalent, which, it was understood, would be used to redeem stock upon a tender offer. As will be seen, the deal took a somewhat different shape as it was finally

structured. Wilson was invited to send a representative to Crofton to spend a week to become familiar with the operation and the property. Armstrong made at least two trips there for that purchase before the purchase contracts were later signed.

On November 26, 1973, Wilson wrote to Crawford (Ex. 5), stating that he had been discussing the transaction with his lawyers and also with Armstrong and Wilson's son, Spence, both of whom happen to be M.B.A.'s, and proposed a new agreement. The net of it was that Wilson would buy one-third of the Crawfords' stock at $14.00 per share, giving them a three year note secured by Holiday Inns stock. The corporation at the same time would make a tender offer to all stockholders to purchase two-thirds of their stock at $14.00 per share. Crawford would agree that "when this trade is consummated" the book value of the Crawford Corporation stock would be at least $14.00. If the corporation did not have the $7,500,000 to purchase all of the stock sought by the tender offer, the Crawfords would take the corporation's note for the balance due to them. The contract would contain the usual warranties as to correctness of the balance sheet. As will be seen, this is the form the transactions ultimately took.

On December 31, 1973, a meeting was held in Memphis attended by Crawford, Wilson, Gittlin, Ness (Crawford Corporation's lawyer) and Apperson (another of Wilson's lawyers). It was agreed that the stockholder-directors other than Crawford would sell one-third of their shares to Wilson and the rest to the corporation under the tender offer under the same terms as the Crawfords were selling their shares.

On April 10, 1974, the Crawfords' sale contract was signed in the office of Wilson's attorneys in Memphis. Under such contract, the Crawfords agreed to sell to Wilson one-third of their shares (that is, 164,417 shares,) and two other director-stockholders, Mack Hornbeak and Dorothy Kimball, also

agreed, by contracts with the same terms executed May 7, 1974, to sell to him one-third of their shares, that is, respectively, 6,668 and 3,468 shares. (The other stockholder-director, Howard Davis, made the same agreement, but had much less stock and is not involved in this litigation.) The price was $14.00 per share, Wilson to pay to the Crawfords $50,000 in cash as down payment and to give them secured, non-negotiable, three-year notes in the amount of $2,206,318.05 for the balance. Hornbeak was to receive $2,025.74 in cash and note in the amount of $89,592.58, and Kimball was to receive cash of $1053.58 and note in the amount of $46,596.74. The contract also provided that Crawford Corporation would make a tender offer, a copy of the tender offer being exhibited to these contracts, to purchase two-thirds of the shares of all stockholders at $14.00 per share for cash, except that the Crawfords would take the corporation's notes for most of the purchase price of their shares. The other provisions of this cotract will be discussed herein later in connection with the contentions of the parties. Specifically, we will discuss in detail the warranty provisions in the contracts with respect to the financial statement of Crawford Corporation of December 31, 1973 and with respect to book value of the stock in connection with Wilson's claims for set-offs based on breach of warranty. The status of several ongoing sale transactions of properties was discussed at this meeting at which the contract was signed.

At this point, we mention that in making the foregoing findings as to the discussions at meetings leading up to and the signing of the contracts, we relied in large part on memoranda made at the time by Gittlin and which are exhibits in the record.

The closing of the stock sale contracts between Wilson and the sellers occurred in Memphis on May 7, 1974. At that time Crawford delivered to the new "Operators of Crawford Corporation" a statement, to which was attached unaudited financial statements of the corporations as of April 30, 1974, and

describing such matters as bank accounts, certificates of deposit, records of corporation, insurance policies, and names and locations of lawyers who had represented the corporations, the corporations' consultants, and certified public accountants. There was also information concerning the status of ongoing sales by the corporations. Armstrong, in behalf of the new owners and management, picked up the records of the corporations at Baton Rouge the next day, on May 8, 1974.

The tender offer by Crawford Corporation was issued on April 12, 1974 and was concluded on or about June 26, 1974. Pursuant to the tender offer, the corporation acquired the remainder of the stock of the Crawfords, Hornbeak, Kimball, and Davis as well as some of the stock of other stockholders, Hornbeak, Kimball, Davis and other stockholders receiving all cash and the Crawfords receiving cash or equivalent of $2,102,000.00 and the corporation's non-negotiable notes of $2,311,304.00, maturing in June of 1979.

Covington Funding, Gittlin's firm, which had earned a fee from the Crawfords, Hornbeak, Kimball, and Davis in connection with their sale to Wilson, by arrangement between the parties, received cash and notes from Wilson to cover such fees. Similarly, Covington Funding, pursuant to the tender offer, had earned fees from stockholders who tendered their stock, and therefore Covington Funding received cash from Crawford Corporation. The effect of this was that the stockholders of Crawford Corporation received cash or notes equal to $14.00 per share less the fees earned by Covington Funding.

Matters ran smoothly, it appears from the testimony, as between the Crawford faction on the one hand and Wilson and Crawford Corporation under its new owner on the other, until the events occurred which precipitated this litigation in April 1977, except for a dispute concerning the notes issued to the Crawfords pursuant to the tender offer by the Crawford Cor-

poration. The tender offer had provided that such notes would contain a provision to the effect that, as the corporation sold off real estate, it would pay over such proceeds, less related taxes and epenses, to the Crawfords on these notes. The notes as originally issued to the Crawfords contained no such provision but, in January, 1975, after some controversy, notes with substantially such a provision were finally issued to the Crawfords. Since then, pursuant to such provision, the Crawfords have received some payments as property was sold, but they contend that the notes became in default before their maturity because Crawford Corporation failed to comply with respect to other sales of property. In any case, the notes are in default now since the maturity date of June, 1979 has passed without payment of the balance.

In November and December of 1974, the accountants who had taken over auditing for Crawford Corporation, Touche Ross, determined that the reporting in the December 31, 1973 financial statements for a couple of substantial real estate sales that had been made by Crawford Corporation prior to the end of 1973 must be restated. These are referred to in the record as the R-22 or Arcroft transaction and the D'Arco and Kelly transaction. The accountants determined that these transactions were improperly treated as completed sales in preparing the balance sheet of December 31, 1973, that these properties should have then been reflected in the preparation of the corporation's balance sheet at their much lower historic cost; this restatement was made at the time Touche Ross prepared the balance sheet effective December 31, 1974.* Although this restatement reduced the stockholders' equity and thus book value of stock substantially below that which had been reflected on the December 31,

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* The December 31, 1973 financials are attached to the Crawfords' sales contract of April 10, 1974 (Ex. 8(a)) and are also in the record as Ex. 52. They were prepared by Bourgeois, Bennett, etc., c.p.a.'s of Baton Rouge. The Touche Ross restatement is Exh. 95.

1973 balance sheet that had been warranted to be correct in the sale contracts to Wilson, no question was raised by Wilson at that time about any breach of warranty.

In December, 1976, Wilson asked Crawford to come to Memphis to discuss the affairs of Crawford Corporation, it having purchased National Polymer Corporation which turned out to be a "total disaster," and to discuss payment of Wilson's notes to the Crawfords and the others from whom he had purchased stock. The notes were to mature on May 7, 1977. Wilson had had some financial problems since 1974 and told Crawford at the meeting that he would not be able to pay the notes when they matured. He asked to have the notes extended and suggested that he would make some current payment if this were done, Crawford flatly refused the extension. Wilson testified that he also mentioned that he was entitled to some set-offs pursuant to the stock sales contracts because of breaches of warranties made in such contracts. Crawford, in his testimony, denied that Wilson mentioned set-offs. We believe that Wilson's memory in this regard is faulty since he continued to make regular interest payments on the full amount of notes through March 31, 1977. Also, it seems unlikely that Wilson would be asserting possible set-offs at the same meeting he was asking Crawford to extend the maturity date of the notes. In any case it is clear that Wilson does not even claim that he raised the question of set-offs at all before December, 1976 although his accountants, Touche Ross, had made the determinations that would be the basis for most of such claims in November, 1974.

On April 5, 1977 Wilson wrote (Ex. 93) to the Crawfords, Hornbeak, Kimball, Davis and Gittlin of Covington Funding a formal letter, pointing out that the sale contract provided that he would have the right to reduce the balance due on the notes by the extent to which the cumulative effect of all breaches of warranty reduced the book value per share of the stock that he

purchased, after completion of the tender offer, below $13.50. In this letter, Wilson also pointed out that in the sales contracts the sellers had warranted the correctness of the financial statement of December 31, 1973 and stated that he had relied on such warranty in agreeing to pay $14.00 per share and agreeing to the corporation's paying $14.00 per share under the tender offer. He stated that Touche Ross had found it necessary to restate the financial condition of the company in order to comply with generally accepted accounting principles. (This involved, as before stated, the transactions referred to as R-22 or Arcroft and D'Arco and Kelly.) He also based his claim for set-off on the fact that Crawford Corporation had taken back, in June, 1974 at a loss some property sold to Tradewinds Investment Corporation as to which Crawford had by letter at the closing agreed to indemnify him. He further stated that the net worth of Crawford Corporation had been further reduced by state and federal taxes that had accrued prior to December 31, 1973 and were paid later. Wilson also stated that the December 31, 1973 statement was further in error since it had not made an allowance for a partial bad debt with respect to some notes secured by purchase money mortgage from ARC Developers.

In this letter, Wilson not only claimed a set-off based on the extent by which the book value of his stock was below $13.50 because of the above stated matters, he also seemed to assert an additional set-off equal to the entire amount paid or to be paid by the corporation to complete the purchase pursuant to the tender offer. Thus Wilson came up with a book value of $6.09 per share and claimed a set-off of $7.41 per share ($13.50 minus $6.09) with respect to the 175,037 shares that he purchased.

Before going further, we pause to point out that Wilson's claim to set-off based on the entire amount paid or to be paid to acquire stock under the tender offer is obviously without merit since such payment under the tender offer was contemplated under the contracts by which Wilson purchased his stock. In

any case, in this litigation, as reflected by post-trial briefs, Wilson is asserting no damages to himself by virtue of the payment under the tender offer, but Crawford Corporation is asserting a claim against Crawford on the theory that, as then chairman and president of the corporation, he violated a fiduciary duty and was guilty of fraud and breach of warranty in stating the book value, in minutes of a directors' meeting, of the stock as $13.59 at the time the corporation agreed to pay $14.00 a share under the tender offer.

Following Wilson's letter claiming set-offs, the Crawfords sued Wilson on May 11, 1977 on their notes that had matured and were unpaid on May 7 for $2,206,319.05 and interest and costs. Wilson filed an answer and counterclaim on May 27, 1977, which was amended from time to time, in which he denied liability for the amount of the notes and claimed set-offs based on breach of warranty under the sale contract, common law fraud and violation of Tennessee blue sky and federal securities laws with respect to his purchase of stock from the Crawfords.

Hornbeak and Kimball brought similar actions against Wilson on their unpaid notes on May 27, 1977, demanding recovery of, respectively, $89,590.58 and $46,594.74 plus interest and costs. Wilson filed similar answers and counterclaims on June 27, 1977.

On June 29, 1977, Wilson brought an action for a declaratory judgment against Covington Funding to determine his liability to it under the notes he issued to it in the amount of $48,733.35 to cover its fee in connection with sale of stock. These notes provide that they are subject to the set-off provisions of the contracts under which Wilson purchased Crawford Corporation stock. Wilson alleged he is entitled to a set-off for breaches of warranty, which Covington Funding denied and counterclaimed for the amount of the notes plus interest and costs.

On May 27, 1977, Crawford Corporation filed an action for declaratory judgment against the Crawfords. The complaint admitted that on the note to Crawford of $1,733,154.00 and to Mrs. Crawford of $578,150.00, a total of only $168,830.33 of principal has been paid. Crawford Corporation alleged that the Crawfords are liable to it for breach of warranty under the stock sales contract of April 10, 1974 (as to which we granted summary judgment to the Crawfords on May 19, 1978 since the warranty did not run to the corporation) and are liable to it for common law fraud and fraud under the Tennessee blue sky and federal securities laws in the inducement of the tender offer and by later amendment alleged breach of duty to the corporation under Delaware law. The Crawfords denied such allegations and counterclaimed for the principal balance due plus interest and costs.

Statutes of limitation defenses are advanced as to all of the claims asserted by Wilson and Crawford Corporation based on common law or statutory fraud or breach of fiduciary duty, and therefore we will deal with such defenses at this point. We will not set out in detail the reasons for our conclusions as to which statute applies and when it began to run since such is largely set out in three orders entered on May 19, 1978, July 24, 1979, and September 25, 1979. As will appear later, we are not dealing with statutes of limitation with respect to breach of warranty claims under the stock sales contracts because those contracts expressly allowed Wilson three years from closing to assert such claims in writing.

T.C.A. § 48-1652, a two-year statute, applies to the claims of common law fraud, breach of fiduciary duty, and fraud under federal security laws and this statute began to run on its effective date, May 28, 1975.

Since Wilson's counterclaim against the Crawfords was filed on May 27, 1977, it is not barred as to claims to which § 48-1652

is applicable. Similarly, since the Crawford Corporation's action against the Crawfords was filed on May 27, 1977, it is not barred as to such claims.

Since the statute applicable to claims under the Tennessee blue sky laws is either a one-year statute (§ 48-1645A) or a two-year statute (§ 48-1652)* and since Wilson and Crawford Corporation clearly knew all of the facts on which the claims are based no later than November, 1974, all such claims are barred, and we granted summary judgment to such effect in orders entered May 19, 1978, July 24, 1979 and September 25, 1979.

Since Wilson's counterclaim against Hornbeak and Kimball was not filed until June 27, 1977, all of Wilson's claims against them to which § 48-1652 applies are barred, and we granted summary judgment to such effect in the orders entered on July 24, 1979 and September 25, 1979.

As to Covington Funding, the only claim for set-off made against it is for breach of warranty under the sales contract, and therefore there are no statutes of limitations problems as to that action.

This brings us to the claims by Wilson for set-offs against the claims of the Crawfords, Hornbeak, Kimball and Covington Funding based on alleged breach of warranty under the contracts for sale of Crawford Corporation stock.

Wilson bases his claims on the following provisions in the contracts:

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* As indicated in the aforesaid orders, T.C.A. § 48-1652 began to run on its effective date, May 28, 1975, where it operated to shorten the then existing period of limitations and began to run at the time the cause of action arose where it operated to lengthen the period of limitations.

5. *Warranties and Representations of Stockholder.* Stockholder does represent and warrant to Wilson that:

(e) Company has heretofore delivered to Wilson a consolidated balance sheet for Crawford Corporation and its subsidiaries, and a separate balance sheet for Crawford Corporation, Crawford Homes, Inc. and Crofton Corporation, all as of December 31, 1973, copies of which are attached hereto as Exhibit "B" and all hereinafter referred to as "Financial Statements." As of December 31, 1973, said Financial Statements were substantially true, complete and correct and were prepared in accordance with generally accepted accounting principles, consistently applied, and fairly represent the financial status of Company and each of its subsidiaries. There are no substantial liabilities, either fixed, or contingent, not reflected in such Financial Statements other than contracts or obligations in the usual course of business, and no such contracts or obligations in the usual course of business or liens or other liabilities, if disclosed, will alter substantially the financial conditions of Company as reflected by said Financial Statements.

11. *Indemnity and Set Off.* In the event it shall be determined within three (3) years after the date of closing that there is a breach of warranty or misrepresentation contained herein, either on the date of execution hereof or the date of closing, and the cumulative effect of all such breaches of warranty or misrepresentations, including all expenses thereof, or in connection therewith, when taken as a whole, if known on December 31, 1973 or on the date of closing, would have been to reduce the book value of the stock purchased hereunder by Wilson below the sum of $13.50 per share, then Stockholder does agree that upon demand, they will reimburse to Wilson, or Wilson may set off against any unpaid balance of the purchase price, a sum equal to the difference between said reduced book value and $13.50 per share.

In event the cumulative or combined effect of all such breaches of warranty and misrepresentations shall not reduce the book value of Wilson's stock below $13.50 per share as above set forth, then Stockholder shall not be liable therefor.

For the purpose of this section, breach of warranty or misrepresentation shall include, but shall not be limited to, the following:

(a) The existence of a claim against, or liability of, company or subsidiaries of any nature, whether accrued, absolute, contingent or otherwise, arising out of facts existing on December 31, 1973 and not reflected in or reserved against in the Financial Statements, or any claim against or liability of Company or Subsidiaries incurred between December 31, 1973 and the closing, other than in the normal course of business, including without limitation, any tax liabilities on transactions entered into or facts existing prior to closing;

(b) The dimunition in value of any real estate or personal property caused by or due to a defect in title or claims by third parties;

(c) Any expenses in connection with the foregoing, including attorney's and accountant's fees incurred in connection therewith and the expense of defending or settling any claim against Company, its subsidiaries or their properties;

This section shall apply to any breach of warranty or misrepresentation notice of which was given to Stockholder within three (3) years from the date of closing, regardless of the date of final settlement of determination.

It is the contention of Wilson that there was a breach of warranty if the book value of the Crawford Corporation stock on December 31, 1973 was not at least $13.50 per share, and he contends that, applying generally accepted accounting principles as called for by the contract, the book value was lower than $13.50 per share. On the other hand, the Crawfords, Hornbeak, Kimball and Covington Funding contend that the book value of the stock on December 31, 1973, applying such principles, was at least $13.50 per share. There was, therefore, a great deal of expert testimony as to how the R-22 (or Arcroft) and the D'Arco and Kelly sale transactions should have been reflected in the December 31, 1973 financials. It was the contention of Wilson that the R-22 property, which had been sold but had been taken back prior to December 31, 1973, should have been reflected in the financials at its historic cost rather than the price for which it had been sold. On the other hand, it is the contention of Crawford that the property was properly stated in that the property was taken back only because he chose to do so since the property had gone up in value, a judgment that proved to be correct since it was sold to Washington Brick & Terra Cotta Co. for $150,000.00 more than at the previous sale a couple of months after December 31. With respect to the D'Arco and Kelly transaction, it was the contention of Wilson that this should not have been reflected as a sale prior to December 31, 1973, but rather should have been reflected at historic cost of the property, due primarily to contingencies in the sale contract, the financial condition of the purchasers, and the plan to restructure the transaction under different terms. It was the contention of Crawford that this was an effective sale prior to December 31 and that this property should not, as Wilson contends, have been reflected in such financials at its historic cost.

Since we agree with the stock sellers' alternative contention (which was their main contention) that under the contract, in

determining book value of the stock, they were entitled to have taken into account, in determining the book value on December 31, what happened to the R-22 property and the D'Arco and Kelly property after December 31, and prior to closing on May 7, 1974, we need not decide whether the handling of these properties in the December 31 financials was in accordance with generally accepted accounting principles. It is without dispute that if the R-22 and the D'Arco and Kelly transactions are viewed as of the time of closing, they would support the book value shown on the December 31, 1973 financials.

It is true that, as Wilson contends, the negotiations for the purchase price of the stock revolved around its book value, and Wilson wanted to get such figure set at as early a date as feasible since the book value was going up as property was liquidated. However, the contracts themselves speak to the "cumulative effect" of breaches as of December 31, 1973 or date of closing and provide that unless they reduce the book value below $13.50, there would be no set-off. At the least, the contracts in this respect are not free of ambiguity. Looking to the actions of the parties, we believe that the parties, including Wilson, did not construe the contract as providing that the sellers were not entitled to the benefit of these sales prior to closing in support of the book value as shown on the December 31, 1973 financials. Wilson, or at least his representatives knew about the R-22 transaction, that the property had been taken back prior to December 31, and about the sale prior to closing to Washington Brick and Terra Cotta and knew that the D'Arco and Kelly transaction was restructured after December 31 and before closing and yet they raised no question about their having been misrepresented in the December 31, 1973 statement. Moreover, Wilson's representatives took over the corporation's books on May 8, 1974 and nothing was said at that time about any breach of warranty. When the dispute arose between Crawford and Wilson as to the provision for the payment of the notes issued

by Crawford Corporation to the Crawfords and resulted in issuing new notes in January, 1975, heretofore referred to, nothing was said about a breach of warranty. When the accountants, Touche Ross, in November, 1974, determined that the R-22 and D'Arco and Kelly transactions had to be restated as of December 31, 1973, nothing was said about a breach of warranty. Nothing was said about there having been a breach of warranty as a result of the handling of the R-22 and the D'Arco and Kelly transactions in the December 31, 1973 financials until Wilson wrote his formal letter on April 5, 1977. Accordingly, relying in large part on the construction of the contract by the parties, as indicated by their conduct, we construe the contract to provide that the R-22 transaction and the D'Arco and Kelly transaction may be viewed as of the date of closing for purposes of determining whether the book values of these properties were fairly reflected in the December 31, 1973 financials.

On the other hand, we believe that the failure to provide for a partial bad debt with respect to the ARC Developers note was not in accordance with generally accepted accounting practices viewed as of December 31, 1973 and that the debt should have been written down to the value of the property securing it, which we find to be a value of $65,000. We further conclude that Wilson is likewise entitled to a set-off because of the necessity of Crawford Corporation paying Maryland taxes for 1967 and 1968 of $57,800.00 and federal income taxes for 1971 of $29,668.00.

At this point we should also point out that Crawford and his associates claim that the figures set out in the foregoing paragraph should be offset by a federal income tax refund paid to Crawford Corporation after the closing as a result of taxes paid prior to December 31, 1973 and not shown in the December 31 financials as a receivable. We do not agree with such contention by Crawford. The income tax refund resulted

from the Touche Ross decision that a sale treated by Crawford Corporation as having been made prior to December 31, 1973 (and on which income tax was paid at that time) should have been treated for income tax purposes as having been made after the date. Thus, while a refund was obtained, income tax was paid on the same profit when Crawford Corporation later recognized such profit.

Since paragraph 11 of the stock sales contracts provides that all claims for "breach of warranty or misrepresentation" contained in the contracts must be made by Wilson in writing within three years of closing (i.e. by May 7, 1977) and since Wilson filed no counterclaims or claims based on alleged breaches of warranty or misrepresentation by May 7, 1977, the only such claims upon which he may rely are those set out in his letter of April 5, 1977, all of which have been dealt with except the claim based on the sale to Tradewinds Investment Corporation, a subsidiary of Levitt Corporation.

It appears that Crofton Corporation sold several parcels to Tradewinds, the one at issue having been sold in 1968. The December 31, 1973 financial statement recognized that Crawford Corporation had received a $228,000.00 cash down payment and a $918,880.00 purchase money note and mortgage for this parcel. In 1971 Tradewinds had sued Crofton Corporation, contending that under contingency provisions in the contract, it was entitled to return the property and have a return of the down payment with an adjustment of interest. Crofton counterclaimed, contending that Tradewinds was obligated to complete the transaction. These actions were pending on December 31, 1973 and at the time of closing. A complete disclosure was made to Wilson or his representatives as to situation with respect to this property.

By letter of May 7, 1974, delivered to Wilson at the closing, Crawford agreed for himself and associates that if Wilson

would waive an opinion letter of counsel as provided by the contract, ". . . any loss which may be suffered in regard to [the pending action] will be indemnified against pursuant to Section 11 of the contract."

After the closing, in June, 1974, Crofton Corporation, with Wilson's approval, agreed to the return of the property to Crofton and return of the down payment to Tradewinds, Crofton keeping all interest received in the amount of $75,000.00. The property was placed back on the books by Crofton at original sale price, but in April, 1975 Touche Ross restated the transaction so that it was written down to historic cost, or $460,000.00, and noted in the December 31, 1974 financials. Since then, Crofton contracted in 1978 to sell the property for $1,800,000.00 although this contract has contingencies.

Wilson made no contention at the time that the property was taken back or later when Touche Ross restated the transaction that there had been a breach of warranty or that he was entitled to indemnity under Crawford's letter.

We believe that there was no breach of warranty with respect to this transaction as of December 31, 1973 or as of the closing date, that is to say, there was an effective sale which the new management decided to undo in June, 1974, apparently because it was thought the property had increased in value. Moreover, under the letter of indemnity given by Crawford, we see no loss to Crofton within the meaning of the letter; Crofton did not "suffer a loss" in the sense of a breach of warranty under the sales contract, and it has not been shown that, as events turned out, Crofton has suffered a loss at all.

Wilson makes claims against the Crawfords, Hornbeak and Kimball based on common law fraud and fraud under federal securities laws (§ 17(a) of the Securities Act of 1933, § 10(b) and § 14(e) of the Securities Exchange Act of 1934, and Rule

10(b)(5) of the Securities Exchange Commission). He contends that the letter of Crawford to him of September 12, 1973 (Ex. 2), stating book values of assets and estimates of market values was a fraudulent statement and that this statement induced him to enter into the contracts to purchase the shares of Crawford Corporation in April and May of 1974.

At the outset we point out that Wilson did not claim that the statements made in the letter were fraudulent and that he relied on them when he wrote his formal letter of April 5, 1977 demanding set-offs based on alleged misrepresentations as to book values. Moreover, when Wilson gave his deposition in December, 1977, he testified in substance that he had never said Crawford was guilty of misrepresentation, that he might have been sincere, that but for the downturn in real estate values after this deal was made, perhaps Crawford's estimates of market values would have turned out to be correct. Wilson further testified at the trial that he "did not think that Mr. Crawford misrepresented anything until I sat here in the courtroom today or yesterday and heard him talk about this $7,500,000. After you hear what he had to say, there is no way in the world that he could have thought that $7,500,000 was going to come in." As has been seen, as far back as November 26, 1973, Wilson proposed that the Crawfords take notes in part payment for their shares surrendered under the tender offer if the corporation did not have the $7,500,000 necessary to pay all cash, and this was actually provided for in the contract of April 10, 1974 and the tender offer.

It is black letter that scienter must be proved to make a fraud claim under common law and such is also necessary under the federal security laws. *Ernst and Ernst* v. *Hockfelder,* 425 U.S. 185. We think Wilson has not shown scienter, read to include recklessness, with respect to most, if not all, of Crawford's estimates of values. Moreover, as conceded in Wilson's brief, it

is necessary that he show reliance, and here we beleive that the record shows that Wilson did not rely on the estimates of market value contained in Crawford's September 12, 1973 letter. The letter shows that the figure as to estimated market values of the properties contemplate a particular kind of development, and the letter projects a book value of the stock per share of $21.23 after sale of such property at the estimated prices. Yet Wilson responded by letter (Ex. 119) on September 19, 1973, in substance, to the effect that Crawford would be better off accepting $12.00 per share for his stock than he would be by holding on to his stock during the further liquidation of the properties, an indication that he did not accept Crawford's estimates of future market values. Accordingly, we find from Wilson's testimony, his statements at the time the negotiations were carried on and from all the circumstances that Wilson did not rely on Crawford's estimates of market values of the properties.

Thus we conclude that Wilson has not proved a claim against the sellers to him of the Crawford Corporation stock on the basis of common law fraud or violation of federal securities laws and regulations.

Crawford Corporation, as a set-off with respect to the balance due on the notes that it issued to the Crawfords, contends that Crawford was guilty of fraud under the common law and violation of federal securities laws and guilty of a breach of fiduciary duty under Delaware law when he signed minutes of a directors' meeting (prepared by attorney Theodore Ness) of Crawford Corporation on April 12, 1974 to the effect that the book value of stock was $13.59 per share and in approving the tender offer stating that $13.74 per share ($14.00 less Covington Funding's fee) was a fair price for the stock.

Wilson does not bring this action as a shareholder's derivative action in behalf of Crawford Corporation; the action is by the

corporation to recover for a fraud and breach of fiduciary duty committed by one of its directors.

It is difficult to conceptionalize precisely how the corporation was damaged even if it paid or is obligated to pay more for its stock under the tender offer than was the actual book value of the stock. Certainly there would be no real damage if it paid more than book value per share if it purchased the same proportion from each stockholder. Perhaps the other stockholders who still held stock after the tender offer would be damaged, but they are not complaining.

In any case, for reasons we have already explained in detail, it is the view of this court that as of the time the directors met and the tender offer was made, the book value of the stock of Crawford Corporation was substantially as much as stated in the minutes and therefore Crawford committed no fraud or breach of fiduciary duty in making such statement in the minutes and in approving the tender offer. We will therefore, on this branch of the case, not review the facts having to do with book value. Nor is it necessary to review federal securities law or Delaware law; there can be no fraud under such federal statutes and breach of fiduciary duty under such Delaware law if Crawford's statements were substantially correct at the time they were made.

We therefore find and conclude that the suing stockholders are entitled to judgment for the balances due plus accrued interest subject to appropriate set-offs as herein indicated. The Crawfords contend that they are entitled, on the notes issued to them by Crawford Corporation, which carry interest of only 4%, to interest at the legal rate from the time the principal came in default, and in this connection they contend, as heretofore stated, that they became in default prior to their maturity. We disagree with this contention. The set-offs, which should be on a pro rata basis, will be a total of: (1) the amount by which the

principal balance and accrued interest on the ARC Developers notes, as shown on the December 31, 1973 financials, exceeded the reasonable value of the property ($65,000) plus (2) the Maryland and federal taxes of $87,468.00 plus (3) reasonable attorneys fees.

The parties will confer and determine whether they can agree on the amount of the judgments within the provisions of this memorandum, subject to right of any party to appeal these decisions.

ENTER this 28th day of July, 1980.

/s/ BAILEY BROWN
Circuit Judge
Sitting by Designation

APPENDIX D

No. 81-5066
No. 81-5067

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

W. Hamilton Crawford, Lillian W. Crawford,
Mack Hornbeck, Dorthy C. Kimball,
Plaintiffs-Appellees,
Cross-Appellants,

v.

Kemmons Wilson,
Defendant-Appellant,
Cross-Appellee.

Crawford Corporation,
Plaintiff-Appellant,

v.

W. Hamilton Crawford, Lillian W. Crawford,
Defendants-Appellees.

Kemmons Wilson,
Plaintiff-Appellant,
Cross-Appellee,

v.

Covington Funding Company,
Defendant-Appellee,
Cross-Appellant.

Appeal from the United States District Court
for the Western District of Tennessee

Decided and Filed November 24, 1982

Before: Lively and Martin, Circuit Judges; and Rubin, District Judge.*

Lively, Circuit Judge. This diversity action was begun by Hamilton Crawford and Lillian Crawford, husband and wife, (hereafter "Crawford," since Hamilton Crawford acted for both throughout the transaction which culminated in this lawsuit) filing suit against Kemmons Wilson (Wilson) to collect on two promissory notes in the aggregate principal amount of $2,206,319.05. In his answer and counter-claim Wilson pled fraud in the inducement by which he executed the notes and breach of warranties which entitled him to set-offs that reduced the amounts payable on the notes. The warranty and set-offs provisions on which Wilson relied were contained in a stock purchase agreement between him and Crawford. He asserted the same defenses against other parties to similar stock purchase agreements. Two of these parties (Mack Hornbeak and Dorothy Kimball) sued Wilson separately, and two corporate entities, Crawford Corporation (the Corporation) and Covington Funding Co., were either plaintiff or defendant in two other related actions. The five actions were consolidated for trial before the district court. A belated motion by Wilson for a jury trial was denied. All parties have appealed from the judgment of the district court, and the appeals were consolidated in this court for hearing and decision.

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*The Honorable Carl Rubin, Chief Judge, U.S. District Court for the Southern District of Ohio, sitting by designation.

I.

A.

In an interlocutory order the district court succinctly and accurately stated the background of this lawsuit as follows:

> Sometime in 1973, Kemmons Wilson entered into negotiations with W. Hamilton Crawford concerning the acquisition of the Crawford Corporation. During the course of those negotiations, Wilson recieved a letter from Crawford outlining the values of the assets of the Crawford Corporation and its subsidiaries. In addition, Crawford provided Wilson with t he current financial statements establishing the book value of the corporation's stock. As a result of these negotiations, Wilson and Crawford executed a Stock Purchase Agreement on April 10, 1974, which provided that Wilson would purchase one-third of the Crawford Corporation stock owned by Crawford and his wife. The remaining two-thirds of the Cr wfords' stock was purchased by the Crawford Corporation. As part of the consideration for their stock, the Crawfords received promissory notes from both Wilson and the Crawford Corporation. Similar transactions were utilized to purchase the Crawford Corporation stock owned by Dorothy Kimball and Mack Hornbeak. The stock acquisition was completed on May 7, 1974 at which time Kemmons Wilson assumed control of the Crawford Corporation.

B.

Wilson was interested in purchasing Crawford's stock only if a way could be found for the Corporation to provide most of the necessary funds. Thus it was that A. Sam Gittlin, president of Covington Funding Co. of New York, proposed a plan by

which Wilson agreed to purchase one-third of Crawford's stock with the understanding that the Corporation would make a tender offer for approximately two-thirds of the outstanding stock with cash on hand or to be generated by the sale of assets. By employing this device Wilson would eventually own a clear majority of the outstanding stock of the Corporation with a relatively small cash outlay.

During the negotiations between Crawford and Wilson and their agents it was always understood that the basis of any sale of Crawford Corporation stock would be its book value. Crawford originally asked $16 per share, which he supported in a letter to Wilson dated September 12, 1973. In the September 12 letter Crawford listed the audited book value of Corporation stock as of December 31, 1972 ($12.70 per share); the unaudited values as of July 31, 1973 and September 30, 1973 ($13.78 and $14.24 respectively); and the projected, unaudited value as of December 31, 1973 ($15.17). In the letter Crawford also estimated the future sales of assets of the Corporation consisting of unimproved real estate. He projected their sale at more than $12 million compared with a book value of about $4 million and an after-tax profit on sales of $4,296,735. Crawford also stated in the letter than an additional after-tax profit "of $3,000,000 to $4,000,000 should develop if all assets are built and sold." Wilson responded with an offer of $12 per share for all of Crawford's stock.

C.

On April 10, 1974 Crawford and Wilson executed an agreement which embodied the Gittlin proposal for sale of one-third of the Crawford stock to Wilson to be followed by a tender offer from the Corporation for the purchase of two-thirds of the stock owned by each stockholder. Crawford agreed to accept the tender and sell to the Corporation all the Crawford stock which had not been purchased by Wilson. The purchase price

for Crawford's stock was $14 per share. Wilson paid Crawford $50,000 in cash and gave the two non-negotiable notes which are the subject of this action for the remainder of the purchase price. The notes were due and payable three years after the closing date of the transaction and bore interest at the prime rate as defined in the agreement. They were secured by the stock of the Corporation purchased pursuant to the agreement and 50,000 shares of stock of Holiday Inns, Inc. owned by Wilson. The stock of other major shareholders, Hornbeak and Kimball, was acquired by Wilson under similar agreements. The transaction was closed on May 7, 1974.

The agreement provided in part 4, *Conditions Subsequent to Closing,* that the book value of all stock purchased by Wilson "shall be not less than $13.50 per share," after provision for taxes due and to become due. In part 5, *Warranties, and Representations of Crawfords,* Crawford made a number of warranties, including the following:

> Crawfords have heretofore delivered to Wilson a consolidated balance sheet for Crawford Corporation and its subsidiaries, and a separate balance sheet for Crawford Corporation, Crawford Homes, Inc. and Crofton Corporation, all as of December 31, 1973, copies of which are attached hereto as Exhibit "C" and all hereinafter referred to as "Financial Statements." As of December 31, 1973, said Financial Statements were substantially true, complete and correct and were prepared in accordance with generally accepted accounting principles, consistently applied, and fairly represent the financial status of Company and each of its subsidiaries. There are no substantial liabilities, either fixed, or contingent, not reflected in such Financial Statements other than contracts or obligations in the usual course of business, and no such contracts or obligations in the usual course of business or liens or other liabilities, if

disclosed, will alter substantially the financial conditions of Company as reflected by said Financial Statements.

Since December 31, 1973, there have not been, and prior to closing there will not be, any matierial changes in the financial position or assets of Company or Subsidiaries, except changes in the ordinary course of business and there have not been and shall not be prior to closing any payment of dividends or distribution in respect to capital stock except as set forth in Section 3 of this Agreement, nor shall there by any material increase in compensation payable to any of the officers, employees or agents of the Company.*

It is understood that Company has contracts for the sale of certain of its real estate, said contracts being noted in Exhibit "D" hereto, which contracts shall be deemed in the ordinary course of business.

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*And liabilities shall not have been increased in an aggregate amount in excess of $100,000.00 excluding income tax liabilities on completed real estate sales and excluding any promissory notes to Crawfords as contemplated herein.

D.

The principal contention by Wilson on appeal of error by the district court is based on that court's treatment of the provisions of the agreement relating to breach of warranty and the right of set-off. Since we have concluded that the proper interpretation and application of these provisions will furnish the key to the correct result in this appeal, we set forth parts 10 and 11 of the agreement in full:

10. **Breach of Warranty.**

(a) **Prior to Closing**. In the event any representation or warranty contained herein shall, prior to closing of this

agreement, be determined to be untrue or breached, then the party to whom said warranty is made may in its sole discretion elect to cancel and rescind this agreement, and this agreement shall be null, void and of no effect, such election shall be made by giving written notice thereof to the other party, specifically describing the breach of warranty relied upon. In the event said party shall elect to proceed with the closing, then he shall not thereafter be entitled to rely upon such warranty or representation.

(b) **Subsequent to Closing.** The warranties and representations contained herein shall survive the closing and shall not be merged therein, provided however, no action shall be brought or claim made in respect to any warranty or representation unless the party taking such action or making such claim shall give notice in writing to the other party within three (3) years after the closing setting forth the nature of the breach of warranty or representation.

11. **Indemnity and Set Off.** In the event it shall be determined within three (3) years after the date of closing that there is a breach of warranty or misrepresentation contained herein, either on the date of execution hereof or the date of closing, and the cumulative effect of all such breaches of warranty or misrepresentations, including all expenses thereof, or in connection therewith when taken as a whole, if known on October 31, 1973, or on the date of closing, would have been to reduce the book value of the stock purchased hereunder by Wilson below the sum of $13.50 per share, then Crawfords do agree that upon demand, they will reimburse to Wilson, or Wilson may set off against any unpaid balance of the purchase price, a sum equal to the difference between said reduced book value and $13.50 per share.

In event the cumulative or combined effect of all such breaches of warranty and misrepresentations shall not

reduce the book value of Wilson's stock below $13.50 per share as above set forth, then Crawfords shall not be liable therefor.

For the purpose of this section, breach of warranty or misrepresentation shall include, but shall not be limited to, the following:

(a) The existence of a claim against, or liability of, company or subsidiaries of any nature, whether accrued, absolute, contingent or otherwise, arising out of facts existing on October 31, 1973 and not reflected in or reserved against in the Financial Statements, or any claim against or liability of Company or Subsidiaries incurred between October 31, 1973 and the closing, other than in the normal course of business, including without limitation, any tax liabilities on transactions entered into or facts existing prior to closing;

(b) The dimunition in value of any real estate or personal property caused by or due to a defect in title or claims by third parties;

(c) Any expenses in connection with the foregoing, including attorney's and accountant's fees incurred in connection therewith and the expense of defending or settling any claim against Company, its subsidiaries or their properties;

This section shall apply to any breach of warranty or misrepresentation notice of which was given to Stockholder within three (3) years from the date of closing, regardless of the date of final settlement or determination.

The Corporation joins in many of Wilson's arguments and also contends that Crawford was guilty of fraud, misrepresentation and breach of fiduciary duty. These latter claims arise from actions of Crawford between the time of the execution of the

agreement with Wilson and the closing of the Wilson transaction. During that period Crawford was in control of the Corporation. He signed minutes of a directors' meeting held on April 12, 1974 which contained a statement that the book value of the stock of the Corporation was $13.59 per share and which approved the tender offer for two-thirds of the stock of each shareholder at $13.74 per share ($14 less Covington Funding's fee) as a fair price for the stock. The Corporation contends that if the latest financial figures of the Corporation, as of December 31, 1973, had been prepared according to generally accepted accounting principles (GAAP) the book value per share would have been substantially less than $13.59. Further, it asserts that Crawford failed to disclose information concerning several transactions which, if known, would have lowered the fair price per share of the tender offer.

II.

A.

By interlocutory orders the district court granted summary judgment to Crawford on the Corporation's claims under federal securities laws and the Tennessee "blue sky law," and on Wilson's claims under the Tennessee statute. These rulings were based on Tennessee statutes of limitation. The court held, however, that none of the various claims for common law fraud interposed by both Wilson and the Corporation or Wilson's claims against Crawford under the federal securities laws were barred by limitations.

B.

The district court's final decision is contained in a lengthy memorandum which summarized the course of dealing between the various parties to the consolidated actions and the relief sought in each of the actions. The holding on which the

judgments was primarily based involved Wilson's right of setoff for breach of warranty. Wilson's claim of a right to set-off was based on the contention that certain transactions by the Corporation were not properly treated in the financial statements of December 31, 1973. Wilson contended that if the "R-22 (or Arcroft)" and the "D'Arco and Kelly" sales transactions "had been recorded in accordance with generally accepted accounting principles the book value of the corporation's stock would have been substantially less than $13.50 per share." The district court found that if these transactions were viewed as of the time of closing, they would support the book value shown on the December 31, 1973 financial statements. The court held, since "under the contract they (Crawford) were entitled to have taken into account, in determining the book value on December 31, what happened to the R-22 property and the D'Arco and Kelly property after December 31, and prior to closing on May 7, 1974, we need not decide whether the handling of these properties in the December 31, financials was in accordance with generally accepted accounting principles."

The district court reached this conclusion upon finding ambiguity in the agreement and then determining from the actions of the parties that "the parties, including Wilson, did not construe the contract as providing that the sellers were not entitled to the benefit of these sales prior to closing in support of the book value as shown on the December 31, 1973 financials." The "actions of the parties" referred to by the court were identified in the memorandum as the failure of Wilson and his advisors to protest at closing, or when the Corporation's books were turned over to them, even though they knew by this time that the R-22 property had been taken back prior to December 31, 1973 and that the D'Arco and Kelly transaction had been "restructured" between that date and the time of closing. Further, though the accountants employed by the Corporation after Wilson took control determined in November 1974 that the R-22 and D'Arco

and Kelly transactions had to be restated, no claim of breach of warranty was made until April 5, 1977. Thus the district court denied Wilson any right of set-off for breach of warranty. The court wrote, "We construe the contract to provide that the R-22 transaction and the D'Arco and Kelly transaction may be viewed as of the date of closing for purposes of determining whether the book values of these properties were fairly reflected in the December 31, 1973 financials."

C.

The district court did grant Wilson set-offs for failure of the Corporation while still controlled by Crawford to provide for a partial bad debt with respect to a transaction referred to as "ARC Developers" and for certain state and federal taxes. The court denied the claim of Crawford and the other sellers that they were entitled to credit for a tax refund received by the Corporation after the closing, as the result of taxes paid before December 31, 1973 and not shown on the financial statment of that date as a receivable.

D.

The district court also denied Wilson's claims based on common law fraud and violations of federal securities laws. The court found an absence of "scienter," which must be present for recovery under either of these claims. The court also found that Wilson did not rely on the estimates of value contained in Crawford's September 12, 1973 letter, a further bar to recovery. Since the stock purchase agreements of Hornbeak and Kimball were identical to that of Crawford, the final judgment in each of the actions against Wilson also reflected the holdings herein outlined with respect to breaches of warranty and set-off. Covington Funding Co. received notes from Wilson for its fee for structuring the sale of the Corporation and the judgment denied Wilson's claim of set-off against these notes as well.

E.

The district court also dismissed the Corporation's action against Crawford for common law fraud, violation of federal securities law and breach of fiduciary duty. The court found that at the time of the April 12, 1974 directors' meeting and when the tender offer was made "the book value of the stock of Crawford Corporation was substantially as much as stated in the minutes and therefore Crawford committed no fraud or breach of fiduciary duty in making such statement in the minutes and in approving the tender offer."

Wilson and the Corporation have appealed and the other parties have cross-appealed from the portion of the judgment which allowed partial set-offs.

III.

A.

The principal issue in this case is a factual one - the meaning of the warranty and set-off provisions of the stock purchase agreement. In this case which was tried without a jury our standard of review is that prescribed by Rule 52(a), F.R. Civ.P.: "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

We agree with the district court that the stock purchase agreement is ambiguous with respect to the critical time at which book value is to be determined. In part 4 of the agreement it is stated that the book value of all stock purchased by Wilson under the agreement shall be not less than $13.50 per share. Since this statement is contained in the portion of the agreement which deals with conditions subsequent to closing it appears to relate to the value following completion of redemption of up to two-thirds of the outstanding stock pursuant to the tender of-

fer. This construction is supported by a letter from Wilson to Crawford, the other sellers of stock and Gittlin of Covington Funding Co., dated April 5, 1977, where Wilson wrote:

> I specifically call your attention to the provisions of the contract in which you warranted to me that the book value of all the stock which I purchased from you, after completion of the tender offer, would not be less than $13.50 per share.

In part 5 of the agreement Crawford clearly warranted that the December 31, 1973 financial statements of the Corporation which reflected a book value of $13.59 per share were "substantially true, complete and correct and were prepared in accordance with generally accepted accounting principles, consistently applied," and fairly represented the financial status of the Corporation. If this description of the financial statements was not true, there was a breach of warranty. However, the district court found it unnecessary to determine whether this warranty was breached because of the limitation contained in part 11 on the right of Wilson to enforce a set-off. That portion of the contract gives Wilson the right to set-off against any unpaid balance of the purchase price an amount equal to the difference between $13.50 per share and the diminished value per share resulting from the cumulative effect of all breaches of warranty or misrepresentations contained in the agreement, "either on the date of execution hereof or the date of closing." This right is specifically limited, however, by the language which immediately follows:

> In event the cumulative or combined effect of all such breaches of warranty and misrepresentations shall not reduce the book value of Wilson's stock below $13.50 per share as above set forth, the Crawfords shall not be liable therefor.

The district court concluded that the parties had construed the agreement to mean that if the book value of the stock purchased by Wilson equalled or exceeded $13.50 per share at closing, the cumulative or combined effect of any misrepresentations would be held not to have reduced the book value, and thus there would be no right of set-off. The district court found that it was undisputed that the book value exceeded $13.50 per share at the time of closing. The only evidence on this point is the testimony of an accountant for the Corporation who was called as witness by Crawford. This witness testified that the book value of the stock on the date of closing was $13.67 per share. This witness was a member of the accounting firm which had agreed to a restatement of the December 31, 1973 financial statement required by the firm hired by the Corporation after Wilson took control. This restatement had resulted in a reduction of book value below the $13.59 per share figure warranted by Crawford. The effect of this testimony was that, since the book value remained above $13.50 per share at the time of closing, the combined or cumulative effect of any breaches had not been to diminish it to a point where a set-off would be available.

B.

Wilson argues that the district court made two fundamental errors in its treatment of his claim of set-off: it misconstrued "cumulative or combined effect" of breaches of warranty and it treated the date of closing rather than December 31, 1973 as the "financial instant" for the transaction. These errors, he asserts, led the court to conclude erroneously that it was not required to determine whether the December 31, 1973 financial statements were as warranted. Wilson contends that if the application of GAAP to the December 31, 1973 financial statements would result in a book value as of that date of less than $13.50 per share he is entitled to a set-off, regardless of book value on the day of closing. The agreement was based on a book value of

$13.50 per share on December 31, 1973, and he was entitled to receive the benefit of any appreciation thereafter, Wilson maintains. Thus, he argues, the "cumulative or combined effect" refers only to the net result of any breaches of warranty on the December 31, 1973 value, and not to the net result of such breaches and of other events or transactions which increased book value. The district court erred, he claims, in considering the net effect of all transactions which changed book value either up or down between December 31, 1973 and the date of closing and then making book value on the latter date determinative of whether Wilson was entitled to an off-set.

C.

The agreement speaks of a breach of warranty "either on the date of execution hereof (April 10, 1974) or the date of closing (May 7, 1974)." On November 28, 1973, after Wilson had agreed to buy Crawford's stock at $14 per share but before the details had been set out in a contract, Wilson wrote Crawford, "You will agree *when this trade is consummated* the book value of the Crawford Corporation will be a minimum of $14.00 per share." (Emphasis added). This figure was changed to $13.50 in the final agreement. The warranty in part 5 of the agreement does not refer only to the condition of the Corporation as of December 31, 1973. It also warrants that no undisclosed contracts, obligations or other liabilities will alter the financial conditions of the Corporation substantially. This warranty appears to refer to the future — to events between December 31, 1973 and some later date. The next paragraph appears to fix that later date as the date of closing.

> Since December 31, 1973, there have not been, *and prior to closing* there will not be any material changes in the financial position or assets . . ., except changes in the ordinary course of business and there have not been and shall not be *prior to closing* any payment of dividends . . . .

(Emphasis added).

The book value per share of the stock of the Corporation as of December 31, 1973 was undoubtedly the bench mark which became the basis of agreement on price between Crawford and Wilson. Wilson was willing to pay a small premium above book value, but prudently required a guarantee that the value would still be there when the transaction was completed. He received this protection in the provision which allowed him a set-off in the event the December 31, 1973 financial statements should not be accurate and the cumulative effect of any breaches and misrepresentations prior to closing should be to reduce the net worth of the Corporation below the agreed figure. On the other hand, Crawford knew that some of the entries on the December 31, 1973 financial statements had been questioned (R-22) and that there were problems with one of the transactions (D'Arco and Kelly) which was still in the process of completion. The provision limiting the right of set-off only to a situation where the cumulative or combined effect of breaches or misrepresentations resulted in a reduction of the book value to a figure below $13.50 per share protected him from being penalized for a breach which resulted in no damage to Wilson. We can find no other explanation for this provision in the contract, and Wilson had supplied none.

The language of the agreement prohibits consideration of breaches individually. Only when their combined effect reduces book value below $13.50 per share do the breaches have any significance. Determination of whether or not breaches occurred is controlled by whether, if known, they would have changed the December 31, 1973 financial statements substantially. However, determination of whether breaches provide relief in the form of a set-off depends on their combined or cumulative effect on the book value at the time of closing. So long as Wilson received the value he bargained for, stock with a book value of at least $13.50 per share, he was not damaged by the fact that its value may have been overstated in the earlier finan-

cial statements which provided one of the bases for his agreement to pay $14.00 per share.

The district court's construction is reasonable and its finding of the intent of the parties is not clearly erroneous. Wilson stated in at least two letters that Crawford was to warrant the value as of the time of completion of the deal.[1] This indicates that he construed the agreement to warrant that the value stated as of December 31, 1973 would still be there when he paid Crawford for the stock. Furthermore, the district court made a finding, contrary to Wilson's testimony, that Wilson did not raise the issue of his claim of set-off at a meeting with Crawford in December 1976. This was long after Wilson had all the information concerning the R-22 and D'Arco and Kelly transactions. Wilson had three years after the closing in which to make a claim of set-off. Thus his failure to raise the issue sooner was not viewed by the district court as a waiver. Rather, in combination with other conduct and writings, this was seen as an indication that Wilson construed the warranty and set-off provisions as providing relief only in the event of Wilson's failing to receive stock with a book value of at least $13.50 per share from Crawford.

Wilson's argument that the parties intended him to reap the benefit of increases in the Corporation's worth does not require a different result. One reason for his interest in the Corporation appears to have been its potential for disposing of some of its assets at prices above their historic book values. It was anticipated that some of these increases would be realized between December 31, 1973 and the date of closing. The proceeds of

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[1] At one time Wilson contended he was entitled to a set-off based on the value of the stock after the tender was completed. However, he did not pursue this claim, and the issue actually tried was whether the court should consider value on the closing date or only as of December 31, 1973.

sales during that period were used to finance the tender offer by which Wilson became the virtual owner of the Corporation with a very small cash outlay. It was only when the Corporation suffered a "total disaster" from an unrelated purchase and Crawford refused to extend the maturity dates of the Wilson notes that Wilson claimed a breach of warranty related to the R-22 and D'Arco and Kelly transactions.

There is some support in the record for Wilson's position that he was entitled to a set-off if the true book value of the stock on December 31, 1973 was less than $13.50 per share regardless of the effect of other adjustments to value between that date and the date of closing. However, the construction of an ambiguous contract requires a factual determination, and our review of the findings of the district court is controlled by the "clearly erroneous" standard. This is not a case where this court "on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948). Thus the district court's denial of the right to set-off under the agreement affords no basis for reversal.

IV.

A.

We find no error in the district court's denial of Wilson's claims based on common law fraud with respect to the September 12, 1973 letter and violations of federal securities law. Notwithstanding Wilson's reading to the contrary, the district court did make a finding that there was no scienter proven. The court did not base its ruling on a lack of reliance alone as claimed by Wilson. The question of scienter is one of fact, and this finding by the district court is not clearly erroneous. Further, there is substantial evidence in the record to support the district court's finding that Wilson, an extremely experienced

real estate developer and trader who viewed some of the Corporation's property himself and sent his representative to investigate the holdings on at least two occasions, did not rely on Crawford's representations and projections of values. The district court properly applied the holdings of *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), and *Edwards* v. *Travelers Insurance,* 563 F.2d 105, 111 (6th Cir. 1977), to the claims for fraud and misrepresentation.

B.

The Corporation sought a set-off with respect to notes which it gave Crawford for the remaining two-thirds of his stock which was purchased pursuant to the tender offer. The district court found that Crawford was not guilty of fraud either under the common law of Tennessee or federal securities law in signing minutes which stated that the book value of the stock of the Corporation was $13.59 per share. There were no warranties from Crawford to the Corporation, so that issue is not involved in the Corporation's appeal. The district court made a finding of fact that at the time of the directors' meeting the book value of the stock was "substantially as much as stated in the minutes . . . ." This finding is not clearly erroneous and it supports the district court's conclusion that Crawford was not guilty of fraud. It also supports the court's conclusion that Crawford was not guilty of a breach of fiduciary duty in this respect. If the value was as stated, Crawford as controlling party committed no wrong in approving the tender offer at $14 per share as he and Wilson had earlier agreed it would be made.

The Corporation makes much of the district court's observation that its claims had not been presented by Wilson in a shareholders' derivative action. This was nothing more than an observation; the district court did not deny relief because of the form of action. The court did comment that it was difficult to conceptualize any damage to the Corporation from setting the

price too high in a tender offer to its own shareholders. Since all shareholders had the same opportunity to tender shares, any diminution in net worth of the Corporation resulting from payments for tendered shares would be precisely the amounts paid on a proportionate basis to the shareholders. Since no non-tendering shareholder had complained, the district court found no right in the Corporation to rely on this claim. All of this discussion by the district court was dictum, however. The holding was that the Corporation had failed to prove a breach of fiduciary duty because the book value was substantially as stated in the minutes.

C.

The district court did not directly address one of the claims of the Corporation.

In its Second Amendment to Amended Complaint the Corporation charged Crawford with breach of fiduciary duty in the restructuring of the D'Arco and Kelly transaction. Though the district court found no breach of fiduciary duty by Crawford in approving the minutes of the directors' meeting it did not address the claim raised in the second amendment. On remand the district court will make findings with respect to the claim which is distinct from those covered in its memorandum.

V.

Turning to the cross-appeal of Crawford and the other noteholders, we believe the district court acted inconsistently in allowing partial set-offs. Upon finding that the per share book value of the stock exceeded $13.50 at the time of closing the district court necessarily found that the cumulative or combined effect of all breaches by Crawford had failed to reduce that value sufficiently to support set-offs. Yet the district court found three separate failures to follow GAAP and allowed a pro rata set-off of the amount by which each of these errors resulted

in an overstatement of book value on the December 31, 1973 financial statements. It was error to consider these items separately. Under the agreement no set-off was permitted unless the cumulative effect of all breaches had the effect of reducing book value below $13.50 per share. The finding that book value was not so reduced precluded any allowance of the set-off claims.

VI.

Both Wilson and the Corporation contend that the district court erred in denying their untimely motions for a jury trial. Such motions are addressed to the sound discretion of the trial judge. The record discloses that the trial judge carefully considered the motions and concluded there was reason to deny them. These consolidated cases involved a great deal of testimony concerning property values, accounting procedures and other complicated evidence. We find no abuse of discretion in the denial of the motion in this case. See *Hyde Properties* v. *McCoy*, 507 F.2d 301, 306 (6th Cir. 1974).

The judgment of the district court is affirmed in part, vacated in part and reversed in part. The cause is remanded for consideration by the district court of the issues identified in part IV-B of this opinion. It is affirmed as to all other issues raised on direct appeal. The judgment is reversed on cross-appeal and remanded for deletion of the set-offs allowed on the basis of breaches of warranty. No costs are allowed on appeal.

APPENDIX E

No. 81-5066
No. 81-5067

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

W. Hamilton Crawford, Lillian W. Crawford,
Mack Hornbeck, Dorothy Kimball,
Plaintiffs-Appellees,
Cross-Appellants,

v.

Kemmons Wilson,
Defendant-Appellant,
Cross-Appellee.

Crawford Corporation,
Plaintiff-Appellant,

v.

W. Hamilton Crawford, Lillian W. Crawford,
Defendants-Appellees.

Kemmons Wilson,
Plaintiff-Appellant,
Cross-Appellee,

v.

Covington Funding Company,
Defendant-Appellee,
Cross-Appellant.

BEFORE: LIVELY and MARTIN, Circuit Judges; and RUBIN, District Judge.*

ORDER

(Filed January 4, 1983)

A joint petition for rehearing has been filed herein by the plaintiff-appellant Crawford Corporation and the defendant-appellant, cross-appellee Kemmons Wilson. Upon consideration the court concludes that the issues raised in the petition for rehearing were fully considered by the court upon the original submission and decision of this appeal and that rehearing is not required.

With respect to the petition of Crawford Corporation it should be noted that the correction has been made in part VI of this court's opinion dated November 24, 1982 showing that the issues to be considered by the district court on remand are those identified in part IV-C. This correction was made prior to transmittal of the opinion to West Publishing Company and the correct reference will appear in *Federal Second*.

The joint petition for rehearing is denied.

ENTERED BY ORDER OF THE COURT

/s/ John P. Hehman
Clerk

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* The Honorable Carl Rubin, Chief Judge, U.S. District Court for the Southern District of Ohio, sitting by designation.